

TEST YOURSELF ON PLANT AND INTANGIBLE ASSETS

True or False

For each of the following statements, circle the T or the F to indicate whether the statement is true or false.

- T F 1. In a broad sense, the cost of a machine or a building may be viewed as a long-term prepaid expense.
- T F 2. An auto owned by a glass manufacturer would be reported under Plant and Equipment, while glass owned by an auto manufacturer would be classified as Inventory.
- T F 3. The cost of land should not include any transaction costs, such as real estate commissions paid.
- T F 4. *Capital expenditures* are those disbursements which are allocated to several accounting periods; *revenue expenditures* are charged off as current expenses.
- T F 5. The cost of a plant asset should include all costs necessary to get the asset ready for use, including the cost of the units spoiled in production while the asset was being adjusted and tested.
- T F 6. A small expenditure, such as \$10 for a set of spark plugs, may reasonably be charged to expense even though the expenditure may benefit several periods.
- T F 7. Obsolescence may be a more significant factor than wear and tear through use in putting an end to the usefulness of many depreciable assets.
- T F 8. Depreciation expense for a period should be a reasonably good estimate of the change in the fair market value of an asset during the period.
- T F 9. In practice, the residual value of an asset is often ignored in estimating annual depreciation expense.
- T F 10. The Accumulated Depreciation account is a fund established for the replacement of assets, but it will not be large enough to cover the cost of replacement during a period of inflation.
- T F 11. The fixed-percentage-of-declining-balance method of depreciation has a "built-in" residual value and can never allocate 100% of the original cost of an asset to expense.
- T F 12. Generally accepted accounting principles require a business to use the same depreciation methods in its financial statements that it uses for income tax purposes.

- T F 13. When it becomes evident that a plant asset will have a useful life longer than had been originally estimated, the depreciation rate will be revised according to the new estimate of useful life.
- T F 14. The units-of-output method of depreciation yields results similar to accelerated methods of depreciation when the rate of output increases steadily over a period of years.
- T F 15. Whenever a depreciable asset is sold, both the cost of the asset and the accumulated depreciation must be removed from the accounts.
- T F 16. For both tax purposes and preparing financial statements, no gain is recognized when used plant assets are traded in on new plant assets of "like kind."
- T F 17. Depletion refers to the allocation of the cost of an intangible asset over the periods that benefits are received.
- T F 18. Intangible assets are assets that cannot be sold.
- T F 19. The systematic write-off of intangible assets to expense is known as amortization.
- T F 20. Goodwill is the present value of future earnings in excess of the normal return on net identifiable assets.
- T F 21. When a business has superior earnings for many years, goodwill probably exists and should be recorded on the books.
- T F 22. If a buyer of a business pays a price for the business in excess of the fair market value of the net identifiable assets, the buyer may record goodwill as one of the assets being acquired.

Completion Statements

Fill in the necessary words to complete the following statements:

1. The two causes of depreciation are: (a) _____ and (b) _____.
2. If a _____ expenditure is erroneously recorded as a depreciation, net income will be _____ in the current period, and overstated in every future period in which depreciation should have been recognized.

3. Net income for three consecutive years was reported as follows:

Year 1	\$30,000
Year 2	\$39,000
Year 3	\$40,000

At the beginning of Year 1, a capital expenditure of \$15,000 for a new machine, which should have been depreciated over a five-year life using the 150%-declining-balance method, was erroneously charged to repair expense. The correct net income for the three years should have been as follows.

Year 1, \$ _____; Year 2, \$ _____; Year 3, \$ _____.

4. The entry to record the disposal of a depreciable asset will always include a credit to the asset account for the _____ of the asset, and a debit to the _____ account.
5. The cost of intangible assets should be _____ by the _____ method.

Multiple Choice

Choose the best answer for each of the following questions and enter the identifying letter in the space provided.

- ___ 1. Big Company purchased land for \$80,000 subject to delinquent property taxes of \$4,000. These taxes were paid immediately by Big Company along with interest of \$320 on the delinquent taxes. The cost of this land should be recorded by Big Company at:
- a. \$80,000.
 - b. \$84,000.
 - c. \$84,320.
 - d. Some other amount.
- ___ 2. If a revenue expenditure is debited to a plant asset account in error:
- a. Revenue for the current period is understated.
 - b. Net income of the current period is overstated.
 - c. Net income in future periods will be unaffected by this error.
 - d. Expenses for the current period are overstated.
- ___ 3. Depreciation, as the term is used in accounting, means:
- a. The systematic write-off of the cost of a natural resource over its productive life.
 - b. The allocation of the cost of a plant asset to expense to reflect the use of asset services.
 - c. The physical deterioration of an asset.
 - d. The decrease in the market value of an asset.

- ___ 4. The book value or carrying value of a depreciable asset is best defined as:
- a. The undepreciated cost of the asset.
 - b. The price that the asset would bring if offered for sale.
 - c. Accumulated depreciation on the asset since acquisition.
 - d. Original cost of the asset.
- ___ 5. The straight-line method of depreciation:
- a. Generally gives best results because it is easy to apply.
 - b. Ignores fluctuations in the rate of asset usage.
 - c. Should be used in a period of inflation because it accumulates, at a uniform rate, the fund for the replacement of the asset.
 - d. Is the best method to use for income tax purposes.
- ___ 6. Accumulated depreciation, as used in accounting, may be defined as:
- a. Earnings retained in the business that will be used to purchase another asset when the present asset is depreciated.
 - b. Funds (or cash) set aside to replace the asset being depreciated.
 - c. The portion of the cost of a plant asset recognized as expense since the asset was acquired.
 - d. An expense of doing business.
- ___ 7. A and B Companies purchase identical equipment having an estimated service of 10 years. A Company uses the straight-line method of depreciation, and B Company uses the double-declining-balance method. Assuming that the companies are identical in all other respects:
- a. B Company will record more depreciation on this asset over the entire 10 years than will A Company.
 - b. At the end of the third year, the book value of the asset will be lower on A Company's books than on B Company's.
 - c. A Company's depreciation expense will be greater in the first year than B Company's.
 - d. A Company's net income will be lower in the ninth year than B Company's.
- ___ 8. Which of the following is not an intangible asset?
- a. A patent.
 - b. A trademark.
 - c. An investment in marketable securities.
 - d. Goodwill.

9. The best evidence of goodwill existing in a business is:
- The appearance of goodwill on the balance sheet.
 - Numerous contributions to charitable organizations.
 - A long-standing reputation for manufacturing a high-quality product.
 - A long record of earnings greater than those of like-size firms in the same industry.
10. Lucky Strike Mines recognizes \$2 of depletion for each ton of ore mined. This year 750,000 tons of ore were mined, but only 700,000 tons were sold. The amount of depletion that should be deducted from revenue this year is:
- \$2,900,000
 - \$1,500,000
 - \$1,400,000
 - \$100,000

Exercises

1. Listed below are eight technical accounting terms emphasized in this chapter.

Half-year convention
Revenue expenditure
Straight-line depreciation
Accelerated depreciation

Goodwill
Book value
Net identifiable assets
Declining-balance method

Each of the following statements may (or may not) describe one of these technical terms. In the space provided below each statement, indicate the accounting term described, or answer "None" if the statement does not correctly describe any of the terms.

- Depreciation methods which take less depreciation in the early years of the asset's life and more in the later years of the asset's life

- The total of all assets except goodwill, less liabilities.

- The present value of future earnings in excess of the normal return on net identifiable assets.

- A method of allocating the cost of an asset equally to each year of its life.

- An expenditure that will benefit only the current accounting period.

f. The cost of an asset minus the related accumulated depreciation.

g. An approach to computing depreciation which records six months' depreciation on all assets acquired during a year, regardless of actual dates of purchase.

2. A truck with an estimated life of four years was acquired on March 31, Year 1, for \$11,000. The estimated residual value of the truck is \$1,000, and the service life is estimated at 100,000 miles. Compute depreciation for Year 1 and Year 2 using the following methods (where appropriate, round depreciation to the nearest month).

	Year 1	Year 2
a. Straight-line	\$ _____	\$ _____
b. Fixed-percentage-of-declining-balance (twice the straight-line rate)	\$ _____	\$ _____
c. Output (miles driven: Year 1, 20,000; Year 2, 40,000)	\$ _____	\$ _____

3. Equipment which cost \$6,000 had an estimated useful life of six years and an estimated salvage value of \$600. Straight-line depreciation was used. In the space provided, prepare the journal entry (omitting explanation) to record the disposal of the equipment under each of the following assumptions:
- The equipment was sold for \$4,000 cash after two years' use.
 - After three years' use, the equipment was sold for \$3,500 cash.
 - After four years' use, the equipment was traded in on similar equipment with a fair market value of \$8,000. The trade-in allowance was \$3,100.

General Journal			
a.			
b.			
c.			

4. The Golden Calf, a Las Vegas gambling casino, had net identifiable assets with a fair market value of \$8,000,000, and earned an average net income of \$2,080,000 per year. Other Las Vegas casinos averaged a net income equal to 20% of their net identifiable assets. An investment group negotiating to buy the Golden Calf offers to pay \$8,000,000 for the casino's net identifiable assets, plus an amount for goodwill.

The investment group determined the amount to be paid for goodwill by capitalizing the Golden Calf's annual earnings in excess of the industry average earnings at a rate of 25%. Compute the total price the investment group is offering to pay for the Golden Calf.

Computations:

Answer: \$ _____

